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ABSTRACT

This Advisory Committee's final report presents study activities, findings, and recommendations for the simplification of the Federal Family Education Loan Program (FFELP). Analysis showed that the current FFELP program structure and operations are needlessly complex and require major reform. An interim report providing recommendations for the restructuring of the FFELP also offers key recommendations for structuring a streamlined direct lending program. The Committee recommended the consolidation of FFELP participants, creation of a single loan program with standard terms and conditions, refinancing provisions, and integration of the loan process into the existing Title IV delivery system. Further, the Committee suggested that any new direct lending program would require minimal interface with the prior FFELP, beyond capture of default information, be a centralized federal program, and have minimal numbers of participants outside the educational institutions. Additional implementation imperatives reported for future student loaning required (1) access to loan capital being maintained for all populations; (2) full integration of the student loan program into the existing Title IV delivery system to minimize the burden on students and institutions; and (3) care in keeping a reformed program from becoming extremely complex. Appendices include a description of recommendations for simplifying the FFELP and the direct lending program. A summary letter is attached. (GLR)

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ED359883

Student Loan Program Simplification: Final Report

A Report of the
Advisory Committee on
Student Financial Assistance

July 1993

HE026580

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Student Loan Program Simplification: Final Report

A Report to the Congress of the United States and the Secretary of Education

Advisory Committee on Student Financial Assistance

July 1993

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FOREWORD

Congress created the Advisory Committee on Student Financial Assistance when it enacted the Higher Education Amendments of 1986. The Advisory Committee serves as an independent source of advice and counsel to the Congress and the Secretary of Education on student aid policy. Congress originally defined its purpose in statute: to provide extensive knowledge and understanding of Federal, state, and institutional programs of postsecondary student assistance; to provide technical expertise with regard to systems of need analysis and application forms; and to make recommendations that will result in maintenance of access to postsecondary education for low- and middle-income students.

The Advisory Committee's most recent focus results from the Education Amendments of 1992, P.L. 102-325, the Higher Education Act of 1965. In particular, the Advisory Committee was asked by Congress to monitor implementation of the Education Amendments of 1992, address unresolved issues of reauthorization, and conduct a study of loan program simplification.

The Advisory Committee's structure reflects the diversity of the contemporary financial aid community. College presidents, financial aid administrators, educational association executives, bank officers, guaranty agency executives, state higher education officials, and students have served on the Committee. Members are appointed by the leaders of the United States Senate, the House of Representatives, and the Secretary of Education on the basis of technical expertise and knowledge of student aid and educational policy. The eleven members serve in staggered terms of three years. These Committee members and Committee staff are listed in Appendix A.

EXECUTIVE SUMMARY

The Advisory Committee on Student Financial Assistance has conducted a congressionally mandated loan simplification study. Analysis of the current loan program has provided the Advisory Committee with compelling evidence that the current program structure and operations are needlessly complex and require major reform. As a result of study findings, the Advisory Committee has developed a comprehensive set of recommendations for simplifying federal student lending.

The Education Amendments of 1992 required the Advisory Committee to conduct a study of simplifying all aspects of the Federal Family Education Loan Program (FFELP). In response to a March 3, 1993, letter from Senator Claiborne Pell, reflecting the views of several senators, the Committee expanded its study to include an examination of direct lending. Federal budget constraints have resulted in Congress considering the conversion of FFELP into a direct lending program in which educational institutions originate loans. Senator Pell specifically requested that the Committee examine how direct loans might be incorporated into the overall Title IV delivery system. The study activities were then refocused to assist in identifying key recommendations for structuring a streamlined direct lending program. Recommendations on both programs were sent to Congress in April 1993, in the form of an interim report, to assist members of the House and Senate as they considered changes to the loan programs in the federal budget process.

Over the course of a year, the Advisory Committee held four hearings in diverse geographic locations, one meeting, and a symposium as primary activities, to solicit views on complexity and strategies for the simplification of student loans. A complete listing of study activities is found in Appendix B. As a result of the written and oral testimony, as well as analysis of the current loan program structure and operations, members determined that complexity in FFELP results from multiple, overlapping loan programs with conflicting terms and conditions. Nonstandard policies, procedures, forms, and processes also plague the program, in addition to burdensome legislative and regulatory requirements. The thousands of parties in the process who are not linked by an adequate data or network infrastructure contribute to the complexity. The results are unacceptable confusion and inefficiency for students and institutions.

The Advisory Committee recommended in its interim report a radical restructuring of FFELP through consolidation of participants, creation of a single loan program with standard terms and conditions, refinancing provisions, and integration of the loan process into the existing Title IV delivery system. Likewise, to create an efficient, effective direct lending program, the new single loan program must be implemented with standard terms and conditions and must be fully integrated into the Title IV delivery system. This program must require minimal interface with the prior FFELP beyond capture of default information and must remain a centralized, federal program with a minimal number of participants outside the educational institutions.

The Advisory Committee has identified some additional implementation imperatives that have arisen from the budget reconciliation process and the resulting challenges over the next five years. As part of its original and ongoing charge, the Advisory Committee maintains a focus on the maintenance of access to higher education for all students. It is critical that as a means of access to higher education *access to loan capital be maintained for all populations*. In addition, the Advisory Committee strongly believes that *the student loan program must be fully integrated into the existing Title IV delivery system if the burden on students and institutions is to be minimized.* In addition, as a reformed program unfolds, care must be taken not to recreate an extremely complex system. Finally, *steps still need to be taken to simplify and streamline the part B program, as well as to ensure that the new direct lending program is kept as least complex and burdensome as possible.*

INTRODUCTION

In the Higher Education Amendments of 1992, Congress charged the Advisory Committee on Student Financial Assistance with conducting a study of simplifying the Federal Family Education Loan Program (FFELP) and submit a final report within one year. In anticipation of the enactment of P.L. 102-325, signed by the President in the summer of 1992, the Advisory Committee initiated its study activities in the spring.

Congress directed the Advisory Committee to focus on the implications of complexity for students and institutions and to make recommendations for simplifying the current student loan program. Specifically, Congress directed the Committee to examine:

- the paperwork burden experienced by financial aid officers within the current structure of the loan program;
- simplification and standardization of forms, procedures, and all other aspects of guaranty operations for the purpose of data exchanges with the Department of Education, its proposed National Student Loan Data Base, and other agencies;
- simplification of the bank repayment process to minimize borrower confusion; and
- efficient utilization of loan programs to minimize multiple program borrowing in postsecondary education.

The Committee approved a study plan in August 1992 that encompassed a number of activities intended to address these specific issues. As part of the "discovery phase" of the study, the Advisory Committee conducted three hearings during the fall of 1992 to solicit community input regarding the sources of complexity in the existing loan process. The Committee received thousands of pages and dozens of hours of testimony from students, financial aid administrators, association representatives, guarantors, lenders, servicers, and secondary market spokespersons.

As a result of a request from the United States Senate, the Advisory Committee expanded its study beyond the statutory charge, to include an examination of direct lending. In particular, the Committee was asked to explore the delivery aspects of the direct loan program and how the lending process could be integrated into the existing Title IV delivery system.

Findings

Based on staff analysis and information presented at its hearings, the Advisory Committee identified six primary sources of complexity. These include:

- Multiple, overlapping loan programs exist, none of which have sufficient annual limits to discourage multiple program borrowing.
- Terms and conditions conflict among the loan programs.
- The programs operate under burdensome legislative and regulatory requirements, most of which have been created to control program costs and default rates.
- Lender and guarantor policies are inconsistent.
- Loan processes and forms are not standard.
- The existing data and network infrastructure is insufficient.

Each of these findings became the focus of intensive investigation in the second phase of the study. The Advisory Committee saw compelling evidence that the current student loan programs are seriously flawed. It became clear that nothing short of fundamental structural reform, especially in program delivery, could simplify and streamline FFELP. The findings also provided the basis for developing a set of recommendations to ensure that direct lending would not mirror the complexity in FFELP.

Committee Solicitation

Using these preliminary findings as general guidelines, the Advisory Committee sent a solicitation in February 1993 to over 350 institutions, associations, guaranty agencies, secondary markets, lenders, and loan servicing organizations asking for recommendations to address sources of complexity. The community submitted thirty-five proposals.

Simplifying FFELP

Analysis of the proposals identified the most promising and feasible recommendations for program reform and confirmed that radical change is required to simplify FFELP. As a result, the Advisory Committee recommends that Congress should:

- Create a new single FFELP with subsidized and unsubsidized components and a single variable interest rate and a standard set of terms and conditions.
- Reduce the number of lenders, guarantors, and secondary markets participating in the new program through a planned and orderly transformation of the existing structures, and require the remaining participants to demonstrate essential administrative capabilities and provide critical services.
- Require that all loans originated under the new program carry the same standardized terms and conditions, including a single variable interest rate, without regard to the borrowers' previous loans under parts B and E.
- Integrate the new program's delivery into an enhanced Title IV delivery system which utilizes the Free Application for Federal Student Aid (FAFSA) as its application document.
- Implement a single source borrowing rule for all students.
- As a condition of participation, require all lenders and holders of loans to allow borrowers to refinance prior loans so that the terms and conditions, including interest rates, are consistent with the new program.
- Establish graduated, income-contingent and extended repayment options, require lenders to offer them to all borrowers, and make expanded repayment mechanisms available to the Department of Education to assist in collections.

Simplifying the Direct Loan Program

The Advisory Committee developed a number of recommendations to ensure simplicity in a direct lending program by proposing that Congress:

- Create a single direct loan program with subsidized and unsubsidized components and a single variable interest rate and standard set of terms and conditions.
- Fully integrate direct lending into the existing Title IV delivery system, with the FAFSA as the loan application.
- Require that holders permit current FFELP borrowers to refinance their FFELP loans under the same terms and conditions as the direct loan program, including the same variable interest rates.
- Enhance the existing Department of Education collection contracts for servicing of direct loans.

- Ensure that no interface between the direct loan program and FFELP is required beyond capture of default information.
- Design direct lending delivery to permit direct interaction between institutions and the Department of Education without numerous intermediaries.

The Advisory Committee forwarded its recommendations for simplifying FFELP and implementing a direct loan program to Congress in its April 1993 *Interim Report*, as the House and Senate were developing budget reconciliation legislation that would have a major impact on the current structure of the student loans programs. As the Committee prepares this final report, Congress is about to engage in a conference that will resolve the differences between the House and Senate bills. The next sections provide some background on the pending legislation, and describes both the imperatives that have arisen from the budget reconciliation process and the resulting challenges to be met over the next five years. The report concludes with a discussion of next steps. The appendices offer readers information on the Advisory Committee membership, a chronology of its loan simplification study activities, and an expanded discussion of the Advisory Committee's recommendation.

THE STUDENT LOAN REFORM ACT OF 1993

Concern about the federal deficit and its implications for all Americans are shaping policy decisions regarding the federal budget. In order to fund new programs, there must be reduction in expenditures for existing programs, including student aid programs. In his budget proposal for 1994, President Clinton clearly indicates that savings must be achieved in funding federal programs without sacrificing quality. The President has focused on the student loan programs as an area in which federal dollars can be saved and program quality improved. In correspondence to Congress which accompanied his proposed legislation on national service and other changes in the student loan programs, President Clinton stated:

> The Student Loan Reform Act of 1993 will take an important first step toward comprehensive reform of the student loan system. It saves money, makes loan repayment more affordable, and holds students more accountable...The Student Loan Reform Act of 1993 replaces the current Federal Family Education Loan Program with the Federal Direct Student Loan Program over a 4-year period. By eliminating subsidies to private lenders and making loans directly to students, direct lending will save taxpayers $4.3 billion through Fiscal Year 1998 and still allow interest rates to drop for student borrowers.... This reform simplifies the system for many students, enabling most to receive all their aid through "one-stop shopping" at their institutions' financial aid office.

Direct lending had been seriously considered during the passage of the Higher Education Amendments of 1992. The program was designated a "demonstration program" as opposed to a phased-in program primarily due to then-President Bush's opposition. The 103rd Congress demanded consideration of any cost savings measures when drafting the federal budget and, therefore, revisited direct lending. Proponents of direct lending contended that since the largest operating cost of FFELP comes from federal subsidies paid to lenders who make the student loans, elimination of such lenders would create an immediate, significant savings of federal dollars under the current congressional budget scoring system.

Both the House and Senate set forth some specific goals for their legislation, as stated in the purpose for both bills:

> ...to simplify the delivery of student loans to borrowers and eliminate borrower confusion...to provide a variety of repayment plans...to replace through an orderly transition, the Federal Family Education Loan Program under part B of this title through the use of a direct student loan program...to avoid the unnecessary cost, to taxpayers and borrowers, and administrative complexity associated with the Federal Family Education Loan Program under part B of this title through the use of a direct student loan program; and...to create a more streamlined student loan program that can be managed more effectively at the Federal level.

Although approaches differ, each chamber passed bills containing some identical elements which will be part of the final legislation. For example, capital provided for the direct loans comes from the federal government under both proposals. In addition, schools that are unwilling or unable to originate loans will be serviced by "alternative originators." Also, the Secretary is permitted to pay a fee (to the institution or its alternate) for origination of such loans; and selection of initial participant institutions relies heavily on prior experience in the Perkins Loan Program and a positive showing on prescribed performance-based criteria. Contractors to the Department of Education play an important role in the administration of the program in both versions. In addition, both bills contain detailed plans for steps to be taken by the Secretary in the case of a guaranty agency failure as a result of the decreased revenue attributable to direct lending. The two bills also exhibit significant differences, which are described below.

House Direct Lending Bill

H.R. 2264, the Omnibus Budget Reconciliation Act of 1993, proposes the total replacement of FFELP with the Federal Direct Student Loan Program (FDSLP) through a gradual phase-in to be completed by July 1, 1997. The proposal eliminates the need for guaranty agencies and lenders in the origination of student loans while maintaining the fundamental number of programs and their associated terms, conditions, and benefits found in FFELP.

The House proposal reflects the Department of Education's desire to allow adequate time to establish systems and resolve problems prior to full implementation. For this reason, only 4 percent of initial new loan volume is shifted to the direct lending program in 1994-95. In the following years, 25 percent (1995-96), 60 percent

(1996-97), and 100 percent (1997-98) of the new loan volume is shifted to the direct lending program.

Interest rates for the direct loans remain identical to FFELP loans until July 1, 1997, when the variable interest rate is reduced significantly. Borrower-paid loan fees are set between 5 percent and 6.5 percent of the principal amount of the loan.

One of the more highly discussed elements of the bill is its consideration of involving the Internal Revenue Service (IRS) in the loan collection process. The legislation mandates a study to determine what role the IRS might take in loan collections, especially for "EXCEL" (income-contingent) loans.

Significantly absent in the bill are any changes to the current FFELP program. A conscious attempt is made to keep incentives in the program in order to maintain participant lenders, guarantors, and secondary markets, thus attempting to ensure access. However, the bills contains restrictions designed to avoid over-taxing guarantor portfolios by limiting the percentage of volume which could be channeled to direct loans. In addition, institutions that choose to participate in direct lending prior to its full implementation lose their part B loan eligibility.

The House bill is silent on significant delivery and simplification issues, leaving many of the decisions on program structure and delivery up to the Department of Education.

Senate Direct Lending Bill

The Senate takes a different approach to "reform" of the student loan program in its budget legislation, choosing a slower, more gradual transition to direct lending, and achieving the required level of budgetary savings through changes in the current program. This allows the existing structure to continue on a parallel track with direct lending. However, budget savings that would have been gained by full adoption of direct lending have to be achieved through reductions in the costs associated with FFELP. As a result, the Senate bill implements significant cuts that effect guarantors, lenders, and secondary markets.

Direct loans are phased-in only to the 50% level of new loan volume in 1997-98. In addition, institutions are permitted to allow students and parents to continue to receive part B loans while

participating in the direct lending program at the discretion of the Secretary. Loan programs would be reduced to one, with the SLS program eliminated and eligibility for independent students for the unsubsidized Stafford program increased accordingly so that students maintain the same level of loan eligibility as in the current program. This creates a dual track system, with simultaneous administration of a direct loan and FFELP programs.

The Senate bill provides the opportunity for evaluation of direct lending. A 15-member bipartisan commission, appointed by the President, (eight members of which are financial aid administrators) will evaluate both FFELP and FDSLP, presenting a final report no later than January 1, 1997, with final recommendations on the advisability of replacing FFELP with direct lending. In addition, the General Accounting Office will issue a report comparing direct lending institutions with a part B control group.

The bill specifies that the origination fee paid by the borrower on direct loans is 4 percent. For FFELP loans, the origination fee is lowered from 5 percent to 3 percent. In addition, all lenders are required to deduct a .5 percent fee from loans appearing on their federal billing statement.

Senate language is much more prescriptive on a number of delivery system issues, then the House. The common financial reporting form (the FAFSA) is the application document. The Secretary would be required to develop, print and distribute a standard promissory note. In addition, loan records are maintained and reconciliations performed in a manner consistent with the Pell Grant program.

A very significant element of this legislation is its specification of reductions in subsidies for FFELP participants. A transfer fee is imposed on all loans that are sold, transferred or assigned, impacting all secondary markets. Guaranty agency reinsurance rates and Sallie Mae insurance rates on defaulted loans are reduced. In addition, Sallie Mae is required to pay to the Secretary an "offset fee" on all loans made, insured or guaranteed. Holders of Consolidation Loans (of which Sallie Mae is one of the largest) are required to pay to the Secretary a rebate fee. The quarterly special allowance paid to holders who purchase loans with the proceeds from tax-exempt bonds is reduced.

The Senate also makes other changes to the existing programs by: eliminating the SLS program and increasing the loan limits for unsubsidized Stafford loans in part B; reducing the maximum PLUS loan to $10,000 and requiring multiple disbursement of such loans; and permitting borrowers to refinance their existing loans to obtain a variable rate or single repayment schedule.

Conference Committee

Preparation for Conference Committee is occurring as this report is being prepared. Congress faces a major challenge in reaching agreement on the two bills, and it is impossible at this point to predict the content of the final legislation.

With the focus solely on cost savings, a number of the Advisory Committee's key proposals could not be addressed in the context of the Student Loan Reform Act legislation. However, a number of the recommendations that which appear in the Advisory Committee's *Interim Report* are contained in one or both versions of the bills before the Conference Committee. These include:

- integrating direct lending into the Title IV delivery system;
- setting the interest rate on all new (FDSL) loans at the variable rate, without regard to borrower loan history;
- using the FAFSA as the loan application;
- permitting current loans to be refined at the variable interest; and
- expanding borrower repayment options.

Further action will be necessary to address the remaining imperatives for the student loan program, as described in the next chapter.

NEXT STEPS

As the Advisory Committee looks toward the future of student loans, three fundamental implementation imperatives emerge that are essential to the success of any new or revised student loan program:

- Access to loans must be maintained for all populations.
- All student loans must be fully integrated into the existing Title IV delivery system.
- Simplification of the loan programs must be ensured.

The next five years will bring a very different system into existence from the one in operation today. No one can predict the exact shape of what is to come. However, a very dynamic transition period is likely to bring unique challenges and opportunities.

Assuring Access

Assurance of access to loans for all populations could be a major issue for both direct loans and the part B programs during any transition phase. As the number of lenders and guarantors decreases, some institutions may need new sources of funds for their continued participation in FFELP. To ensure access and availability of funding, it is imperative that there be a sense of order and control as the system evolves.

In this changing environment, the Department of Education will be faced with some serious management challenges. A systematic transformation and orderly transition is essential. It can be accomplished if the loan programs are *closely monitored*, with accurate feedback on any changes in loan availability for any sector. In addition, steps must be taken now to ensure that, over the next five years, the Secretary has the authority and administrative mechanisms necessary to assure the availability of guarantees and a functioning, effective lender-of-last-resort program. This includes providing adequate resources to address difficulties as they arise. These mechanisms must be part of a well-defined management plan that can provide a viable, funding alternative should a geographic area or specific population lose access to student loans. In these instances, the Secretary must have prerogative to require the transfer of guaranty authority from one agency to another, to direct

one or more entities to offer lender-of-last-resort loans, or to include affected institutions in the direct lending program.

Integrating Delivery

The significant differences between the Title IV delivery system and student loans delivery have added to the complexity of the student loan programs. There is no reason to continue to support two separate (and, in most cases, redundant) awarding processes and delivery structures that have existed since the beginning of the FFEL program. Further, there is no need to create such a system in any new direct lending model. Both programs must utilize the existing delivery structure in order to eliminate confusion and minimize the burden on students and institutions.

Significant steps have been proposed to incorporate such integration into the design of the direct lending program, such as using the FAFSA as the application document and the Title IV structure as a fund delivery and account reconciliation mechanism. The Department must be mindful of this imperative as the program matures, avoiding the costly development of additional software or programs which unnecessarily duplicate the federal systems in use at institutions.

FFELP requires considerable modification if it is to be integrated into the Title IV structure. Many guaranty agencies would have to alter their operations significantly to accommodate such changes as utilization of the FAFSA as the application document. Standardization, very much needed in FFELP, could be facilitated if the Electronic Data Exchange System (EDE) were used for processing loan data, thus replacing numerous forms of software required by guarantor which are currently on the market. In addition, the Secretary must to make the National Student Loan Data Base immediately and completely operational to avoid unnecessary duplication of activities by competing data bases. By using the existing Title IV structure, the of impact of these changes on institutions would be greatly reduced, and a new system could be developed in a fairly short period of time, eliminating many of the sources of administrative complexity.

Simplification of the Programs

Congress took steps to create a loan program that will be easier to administer, because there are few entities intermediating between

the school and the Department, paperwork is minimized, and loan processing is expedited. However, in the context of budget reconciliation, lawmakers were unable to simplify FFELP.

Many of the elements Congress incorporated into direct lending are identical to recommendations that the Advisory Committee made in its interim report as necessary to create a streamlined program. A few issues remain. First, the number of loan programs from which a student must borrow should be reduced to only one. Congress should consider consolidating the Perkins Loan Program into the single loan program. Second, the direct lending program should not be dependent on FFELP beyond the capturing of default data. Finally, the Department must take steps to ensure that they are able to interact directly with the institutions participating in direct lending, without the imposition of a large number of intermediaries.

Congress must seize the first available opportunity to make the needed changes to simplify and streamline the origination and collection of the current loan program as well. There need be only one loan program in FFELP from which students may receive funds. The number of participants in terms of lenders, guarantors, servicers, and secondary markets must be reduced in an orderly fashion, preserving access to loan capital and those remaining must be administratively capable and provide critical services. All new loans should have the same terms and conditions, regardless of the borrower's loan history. Single source borrowing must be implemented and refinancing must be an option for FFELP borrowers.

The Department and Congress are faced with a final, overarching challenge. That is, at all costs, the direct lending program must be implemented without introducing complex procedures and processes. Before any policy is made, the Department is urged to explore what exists and determine if it represents the simplest, most concise method of achieving the desired outcome. Failure to do so will result in once again confronting students and institutions with complex and confusing loan programs.

Appendix A

LIST OF MEMBERS AND STAFF
Advisory Committee on Student Financial Assistance
Current Members By Class of Appointment

Class of 1993
(Term expires September 30, 1993)

Ms. Lynn M. Fawthrop
Director of Financial Aid
Roger Williams University
Bristol, Rhode Island 02809
(U.S. Senate appointee)

Mr. James R. Craig
Director of Financial Aid Services
Montana State University
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Dr. Horace W. Fleming, Jr.
Executive Vice President and Provost
Mercer University
Macon, Georgia 31207-0001
(Secretary of Education appointee)

Class of 1994
(Term expires September 30, 1994)

Dr. Robert E. Alexander
Chancellor
University of South Carolina-Aiken
Aiken, South Carolina 29801
(Secretary of Education appointee)

Dr. William C. Hiss
Vice President for Administrative Services
and Dean of Admissions
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(U.S. Senate appointee)

Mr. Joseph L. McCormick
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Division of Natural Sciences
College of DuPage
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Mr. Charles E. Peavyhouse
Hixson, Tennessee 37343
(Secretary of Education appointee)

Advisory Committee Staff

Dr. Brian K. Fitzgerald
Staff Director

Dr. William J. Goggin
Staff Economist

Ms. Hope M. Gray
Staff Assistant

Ms. Tracy D. Jones
Staff Secretary

Ms. Ardena N. Leonard
Research Assistant

Ms. Debra L. Schweikert
Associate Staff Director

Appendix B

CHRONOLOGY OF STUDY ACTIVITIES

Date	Activity
July 1992	Study mandated by Congress as part of the Higher Education Amendments of 1992.
August 1992	Approval of study plan at Advisory Committee meeting, Bristol, Rhode Island.
September 1992	Loan Simplification Hearing, Breckenridge, Colorado.
October 1992	Loan Simplification Hearing, Washington, D.C.
November 1992	Loan Simplification Hearing, Seattle, Washington.
December 1992	Analysis, synthesis, and identification of sources of complexity in the student loan programs; preparation of preliminary findings report.
January 1993	Discussion of preliminary findings at Advisory Committee meeting, Washington, D.C.
February 1993	Solicitation of financial aid administrators, associations and the student loan community seeking solutions to complexity.
March 1993	Letter from Senator Pell requesting the broadening of the study's scope to include direct lending; analysis and synthesis of solicitation responses; drafting of preliminary report.

April 1993	Symposium to examine study's preliminary recommendations, Arlington, Virginia; publication of interim report.
June 1993	Discussion of final recommendations at the Advisory Committee hearing, Annapolis, Maryland; letter to the Senate Committee on Labor and Human Resources discussing issues surrounding the Student Loan Reform Act of 1993.
July 1993	Drafting of Final Report; letter to conferees detailing Committee issues regarding House and Senate versions of the Student Loan Reform Act; publication of Final Report.

Appendix C

DESCRIPTION OF RECOMMENDATIONS FOR SIMPLIFYING THE FEDERAL FAMILY EDUCATION LOAN AND DIRECT LENDING PROGRAMS

This appendix presents the Advisory Committee's recommendations for simplifying the Federal Family Education Loan Programs and Direct Lending. An explanation and rationale follows each recommendation.

Recommendations for the FFELP

Create a new single FFELP loan program with subsidized and unsubsidized components, and with a single, variable interest rate and standard set of terms and conditions. Congress should merge the Stafford, SLS, and Perkins loan programs, and create a unified loan program with a subsidized and an unsubsidized component for students. All new loans should be originated with the same variable interest rate and standardized terms and conditions. Loan limits should be combined under the current FFELP and Perkins programs.

> **Rationale:** The multiple and overlapping loan programs authorized under parts B and E of the Higher Education Act, as amended, are a major cause of complexity. Congress can achieve simplification by combining the programs into a single program that incorporates the same variable interest rate for all loans and standardizes other terms and conditions, such as deferment and repayment options. This consolidation will result in much simpler application and repayment processes. For example, borrowers would complete only one application per academic year rather than potentially several applications. Further, they would benefit from automatic administrative consolidation--which rarely occurs under the current system--and they would not have to deal with the often incomprehensible variation in terms and conditions that exist today. The associated reduction in administrative burden on institutions in terms of processing and counseling are obvious.
>
> Consistency in the guarantee fees is also critical. According to testimony provided by several guaranty agencies, differences in these fees across guaranty agencies reflect its use as a marketing tool, rather than as a mechanism for addressing risk in the programs. A standard, set fee may decrease the dependency of some agencies on administrative cost allowance. Differences in fees also suggest unequal treatment of student borrowers.

Reduce the number of lenders, guarantors, and secondary markets participating in the new program while maintaining access to guarantees and loan capital and require the remaining

participants to demonstrate essential administrative capabilities and provide certain critical services. To ensure simplification, Congress should use the need to reduce federal expenditures to minimize the number of loan program participants in a systematic manner in order to maintain access to loan capital. Proposals advanced by lenders, guarantors, and secondary markets to reduce administrative cost allowance and reinsurance rates, require immediate subrogation of defaulted loans, reduce special allowance rates and insurance payments from guaranty agencies, allow borrowers to refinance existing loans to a variable rate, and impose a single holder provision for all of a borrower's loans would inevitably have these consequences.

Further, the requirements for eligible participants should be revised to improve the overall performance of the system. At a minimum, eligible participants should have the capability: to perform electronic funds transfer; to offer refinancing of existing loans; to implement standard forms and processes (including minimum loan amounts, school reporting requirements, frequency of borrower contact, deferment documentation requirements, loan certification rules, and claim review/claim purchase policies); and the capability to provide loan consolidation and income-contingent, graduated and other alternative repayment schedules. In addition, any guaranty agency that wishes to participate in the program must agree to accept transfers of guarantees from agencies which become insolvent.

> **Rationale:** The sheer number of participants in the loan program represented by thousands of lenders, over 40 guaranty agencies, and numerous secondary markets has resulted in considerable expense to the federal government. It has also proven to be a significant barrier to simplification. For example, institutions, students, and their families must contend with forms, policies, and procedures that are unique to individual lenders, guaranty agencies and secondary markets.

Require that all loans originated under the new program carry the same standardized terms and conditions, including a single variable interest rate, without regard to the borrower's previous loans under Parts B and E. This would eliminate the requirement that borrower interest rates must be based on prior loans. A single variable interest rate would replace the existing rates. The same would hold true for other terms, such as deferment and repayment options.

> **Rationale:** The current statutory requirement that all loans of a borrower be held at the interest rate of his or her first loan was originally designed to benefit the student. However, it ceased to be an advantage several years ago when interest rates began declining and borrowers found themselves obtaining loans at noncompetitive rates in comparison to new borrowers. In addition, implementation of this proposal would obviate the need for institutions, lenders, or guaranty agencies to research borrowers' loan histories, thus also decreasing

the need for a historical data base. All borrowers, regardless of their prior borrowing, will be able to obtain an interest rate on all new loans at a rate (in most cases) significantly less than their fixed rate loans. As a result, the federal government will save a considerable amount of money for payment on in-school subsidies and on administrative support for a national loan data base.

Integrate the new program's delivery into an enhanced Title IV delivery system which utilizes the Free Application for Federal Student Aid (FAFSA) as its application document. This year over seven million students in 42 states will rely on the FAFSA alone to deliver their federal, state, and institutional aid. While there would still be a need to generate a separate promissory note, combining the student loan application process into the FAFSA process is the final step in integrating all federal and state financial aid programs into a unified system with a single application.

Rationale: The existing Title IV delivery system functions very efficiently, with over 5,000 institutions currently submitting and receiving data through the Department of Education's Central Processing System (CPS). Enhancements required to add loan information to the existing system would be minimal. The utilization of this system would facilitate the processing of applications and the delivery of funds as well as significantly reduce the paperwork burden associated with the FFELP. In addition, implementation would assure that applicants are considered for all forms of aid for which they may be qualified. Both students and institutions would benefit as a result.

Implement a single source borrowing rule for students. All of a borrower's loans must be guaranteed by one agency, originated by one lending institution, and held by one secondary market or lender under the new program. This would be an expansion of the language found in the Higher Education Amendments of 1992 which encourages, but does not require such a practice. To participate in the program, lenders would not be able to use different servicers for any individual's loan portfolio. In addition, lenders and loan servicers would have to provide a single repayment schedule for all loans of a given borrower and require a single minimum monthly payment to cover all of the borrower's loans. If a borrower wishes to establish a relationship with a new lender or guarantor, all existing loans must be refinanced or transferred to the new lender or agency at the request of the borrower. Wherever possible, all of an institution's loans should be originated, guaranteed, and serviced by a limited number of entities.

Rationale: Single source borrowing addresses a series of problems that exist in the current FFELP program. For example, borrowers are frequently unable to identify the holders of their loans because there may be more than one and loans are often sold by holders to other holders. This prevents borrowers and institutions from successfully communicating with holders about matters that

range from change of address to problems associated with deferments and repayments. If single source borrowing is adopted, borrowers and institutions would be able to identify holders easily. Thus, a single request for information or submission of demographic or enrollment changes to a guaranty agency or lender would update a borrower's file. Students would have to communicate with only one holder about questions and problems and to repay only one entity through a single repayment schedule. This would also minimize the number of entities with which institutions must interact.

As a condition of participation, require all lenders to allow borrowers to refinance prior loans so that the terms and conditions, including interest rates, are consistent with the new program. The proposal facilitates consolidation and would result in a significant reduction in federal interest subsidy expenditures and in potential savings to the borrower.

Rationale: Implementation of the recommendations would benefit both borrowers and taxpayers. For example, repayment terms would be much more competitive for many borrowers, positively affecting the repayment for some who may have otherwise defaulted and resulting in lower costs over the life of the loans for many borrowers. Administrative consolidation would be more widely used because loans could be easily combined into one repayment schedule. Federal expenditures on in-school interest subsidies would also be significantly reduced if existing loans were refinanced at a lower variable rate rather than at the fixed rates. It should also be noted that some secondary markets may be required to reissue taxable bonds which were initially issued on a nontaxable basis because interest rates on the loans in their portfolio were a condition of their original bond issue.

Establish graduated, income-contingent and extended repayment options, and require lenders to offer them to all borrowers. In addition, make expanded repayment mechanisms available to the Department of Education to assist in collections. Flexible repayment options are the key to relieving the burdens of repayment that borrowers often experience. The proposal should also reduce the incidence of default.

Rationale: With the increase in loan limits brought about by reauthorization, some borrowers may find a ten-year fixed repayment schedule yields an unmanageable monthly payment. Consolidation under current program rules, especially if funds have been borrowed from only one program, is too costly an alternative to obtain a longer repayment period. In addition, the borrower's first employment opportunity once out of school may be a low paying position that does not provide enough money to support and repay debts.

Recommendations for a Direct Loan Program

Create a single direct loan program with subsidized and unsubsidized components, with a single, variable interest rate and standard set of terms and conditions. All new loans should be originated under the direct loan variable interest rate, terms and conditions. Congress should abolish the Stafford, SLS, and Perkins loan programs, and create a single direct student loan program with a subsidized component for students and an unsubsidized component. All new loans should be originated with a variable interest rate and terms and conditions. Direct loans should not depend on prior FFELP borrowing.

> **Rationale:** Creation of a single program will reduce both confusion for borrowers and administrative burden for institutions because direct lending abolishes the four overlapping Part B and Part E student loan programs. These programs contribute to complexity as a result of different interest rates and nonstandard terms and conditions, including deferment repayment options.

Fully integrate direct lending into the existing Title IV delivery system, with the FAFSA as the loan application. This would provide a single structure for application processing, data management, disbursement and reporting functions. Data required for awarding all Title IV programs would be processed through the Central Processing System (CPS) and directly delivered to institutions by the Department of Education.

> **Rationale:** The implementation of this recommendation would create a single structure based on the current federal delivery system (i.e., Central Processing System and Financial Management System) for application processing, data management, disbursement, and reporting functions. This structure would capture, retain, and track relevant loan data, thereby eliminating many of the administrative and processing steps required in the current loan system. Paperwork burden would be reduced, delivery of funds would be expedited and simplified, and reporting requirements would be streamlined. As was stated in testimony before the Advisory Committee, originating a loan utilizing the Title IV delivery system should be no more difficult than disbursing a Pell Grant. In addition, the Department would be able to monitor closely changes in fund request patterns, thus potentially identifying problems at institutions much more quickly than the existing system permits. Such problems include fraud and abuse, which can go undetected under the current system due to the absence of an adequate, centralized data base.

Require that holders permit current FFELP borrowers to refinance their loans under the same terms and conditions, including the same variable interest rates, as the direct loan program. Borrowers under direct lending should have the option to consolidate their FFELP loans

through refinancing. FFELP holders must be required to honor the borrowers' requests to refinance.

> **Rationale:** Refinancing will allow all borrowers both to take advantage of much lower interest rates on most outstanding loans and to consolidate or group their loans automatically into a single repayment schedule. The proposal would also considerably reduce federal expenditures on in-school and deferment subsidies.

Enhance the existing Department of Education collection contracts for servicing of direct loans. ED should issue a small number of contracts to servicers that will collect direct loans. Their responsibilities should be expanded to include the capability to offer graduated and income-contingent repayment schedules.

> **Rationale:** In order to minimize the number of servicers with which institutions must interact on behalf of their students, the number of servicing contracts must be small. Expanded repayment options will simplify and streamline the repayment process. In addition, such options may assist in averting default, especially for those individuals with high loan balances.

Ensure that no interface between the direct loan program and the FFELP is required beyond capture of default information. Establish borrower eligibility and other criteria to ensure the independence of the direct lending program. Extensive interactions between the two programs will unnecessarily complicate direct lending. The only interface required should be the capture of default information.

> **Rationale:** Requirements, such as dependency on borrower loan history to originate new loans, would unnecessarily complicate a system of direct lending. If no interface beyond default information is required, there would be no need to continue development of the NSLDB, or to continue processing Financial Aid Transcript requests or Student Status Confirmation Reports. The Central Processing System (CPS) alone would be able to track defaults, as well as annual and cumulative loan limits. The CPS could also monitor and update deferment status. This would significantly decrease the paperwork burden and administrative costs for institutions in addition to simplifying loan counseling and awarding.

Design direct lending delivery to permit direct interaction between institutions and the Department of Education without numerous intermediaries. The primary delivery process for direct loans should link ED directly with institutions. Intermediaries, including alternate originators, should be limited in number and function.

Rationale: The current programs are unnecessarily complicated by numerous intermediaries. The more participants involved, the greater the opportunity for multiple forms, policies, and processes, as is seen in the current program. There is no reason for multiple entities to be involved in the delivery of loan proceeds, since this process can be adequately administered by the institutions involved in the program. The addition of other participants to the program will delay delivery, add to the paperwork and reporting burden, and increase costs of program operations.

Advisory Committee on Student Financial Assistance

July 23, 1993

Dear Colleague:

The Advisory Committee on Student Financial Assistance has conducted a loan simplification study required by P.L. 102-325. Analysis of the current loan program has provided the Advisory Committee with compelling evidence that the current program structure and operations are needlessly complex and require major reform. The enclosed document represents the Advisory Committee's final report on study activities, findings, and recommendations. In addition, the report discusses a number of implementation imperatives of critical importance to the Student Loan Reform Act of 1993.

Analysis of the current loan program structure and operations, and written and oral testimony, demonstrated that complexity in FFELP results from multiple, overlapping loan programs with conflicting terms and conditions. Nonstandard policies, procedures, forms, and processes also plague the program, in addition to burdensome legislative and regulatory requirements. The thousands of parties in the process who are not linked by an adequate data or network infrastructure contribute to the complexity. The results are unacceptable confusion and inefficiency for students and institutions.

The Advisory Committee, in its April 1993 *Interim Report*, recommended a radical restructuring of FFELP through consolidation of participants, creation of a single loan program with standard terms and conditions, refinancing provisions, and integration of the loan process into the existing Title IV delivery system. Likewise, to create an efficient, effective direct lending program, the new single loan program must be implemented with standard terms and conditions and must be fully integrated into the Title IV delivery system. This program must require minimal interface with the prior FFELP beyond capture of default information and must remain a centralized, federal program with a minimal number of participants outside the educational institutions.

The Advisory Committee has identified some additional implementation imperatives that have arisen from the budget reconciliation process and the resulting challenges over the next five years. As part of its original and ongoing charge, the Advisory Committee maintains a focus on the maintenance of access to higher education for all students. It is critical that as a means of access to higher education *access to loan capital be maintained for all populations*. In addition, the Advisory Committee strongly believes that *the student*

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loan program must be fully integrated into the existing Title IV delivery system if the burden on students and institutions is to be minimized. In addition, as a reformed program unfolds, care must be taken not to recreate an extremely complex system. Finally, *steps still need to be taken to simplify and streamline the part B program, as well as to ensure that the new direct lending program is kept as least complex and burdensome as possible.*

Our Committee and staff look forward to providing continual technical assistance in the future. Should you need extra copies of our report or have any questions regarding our recommendations, please direct them to Brian Fitzgerald, our Staff Director.

Sincerely,

Lynn M. Fawthrop

Lynn M. Fawthrop
Chairperson

Enclosure

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